IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MARYLAND

In re: RAILWORKS CORP., et al.	:	Bankr. Case No. SD-01-64463
* * * * * * *	:	
C. WILLIAM MOORE, et al.	:	
	:	Bankr. Adversary No. 05-1238
v.	:	Civ. Appeal No. WMN-06-2058
HENRY D. HOGE, et al.	:	

MEMORANDUM

Before the Court are cross appeals of a decision of the United States Bankruptcy Court for the District of Maryland filed by Appellants C. William Moore, Jeffrey Lewis, Michael Rivera, and Glass & Associates, Inc. (collectively, Defendants), Paper No. 18, and Appellees and Cross-Appellants Henry D. Hoge, Dona P. Hoge, and the Henry D. Hoge and Dona P. Hoge Family Trust (collectively, Plaintiffs), Paper No. 20. Each appeal has been fully briefed and is now ripe for decision. Upon review of the appellate briefs and the applicable case law, the Court finds that no hearing is necessary and that the decision of the Bankruptcy Court shall be affirmed.

I. FACTUAL AND PROCEDURAL BACKGROUND

In 1979, Henry D. Hoge (Hoge) founded HSQ Technology (HSQ), a California corporation specializing in software development and engineering. In May of 2000, HSQ entered into a design/build contract with the Port Authority of Allegheny County, Pennsylvania (PAAC). In connection with that contract, Liberty

Mutual Insurance Company (Liberty Mutual), issued performance bonds guarantying HSQ's performance. To secure the bonds, Plaintiffs signed indemnification agreements with Liberty Mutual agreeing to reimburse Liberty Mutual for all amounts paid and expenses incurred by it in connection with the PAAC contract.

Prior to the formation of the PAAC contract, in 1999, Hoge was approached by Michael R. Azarela and John G. Larkin on behalf of Railworks Corporation (Railworks), a provider of rail systems services. Azarela and Larkin represented Railworks as a financially strong company, expressed an interest in acquiring HSQ, and claimed that HSQ would prosper as a Railworks subsidiary. Railworks formally acquired HSQ in June of 2000, after the formation of the PAAC contract. Defendant Moore served as President of Railworks Transit Systems, Inc. and managed the unified operations of certain other Railworks subsidiaries within what was known as the "Transit Systems Group," of which HSQ became a member.[1] Defendant Michael Rivera served as Vice President and general counsel of Railworks. Defendant Glass & Associates, Inc. served as financial and reorganization consultants to Railworks and its subsidiaries.[2]

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[1] On July 2, 2002, the HSQ board of directors formally appointed Moore as President of HSQ and, under the direction of the Board, on July 16, 2003, Hoge's employment with HSQ was terminated.

[2] Defendant Jeffrey Lewis was an employee of Glass and Associates.

On September 20, 2001, Railworks and twenty-two of its subsidiaries, including HSQ, filed voluntary petitions for relief under Chapter 11 of the Bankruptcy Code. The cases were jointly administered in the United States Bankruptcy Court for the District of Maryland (Bankruptcy Court). In October of 2001, PAAC filed a motion in the Bankruptcy Court seeking to have HSQ assume or reject the PAAC contract. Following a hearing on that motion, the Court ordered rejection of the PAAC contract and, as a result, Liberty Mutual paid approximately $4.5 million to PAAC under the performance bonds. Subsequently, Liberty Mutual obtained a judgment against Plaintiffs in excess of $5 million. On October 1, 2002, the Bankruptcy Court confirmed Debtors' Second Amended Joint Plan of Reorganization which contained a release provision enjoining actions by any claim holder against representatives of the Debtors.[3]

On September 17, 2004, Plaintiffs filed a civil action in the Superior Court of California, County of San Mateo. Former

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[3] The release provision of the Reorganization Plan provides, in pertinent part: "To the fullest extent permitted by applicable law, each holder of a Claim . . . shall be enjoined from commencing or continuing any Cause of Action . . . and shall be deemed to release any Claim or Cause of Action arising from the beginning of time through the Effective Date . . . against any Representative . . . in any way relating to the Debtors, the Reorganization Cases or the Plan; provided, however, that the foregoing shall not operate as a waiver of or release from, and shall not enjoin the prosecution of, any Causes of Action arising out of . . . acts or omissions to act involving willful misconduct, recklessness or gross negligence . . . ." Debtors' Second Am. Joint Plan of Reorganization § 11.6(b).

Defendants Martin Fletcher and Whiteford, Taylor & Preston, LLP, removed the litigation to the United States Bankruptcy Court for the Northern District of California, which subsequently transferred the action to the United States District Court for the District of Maryland. Following referral of the action to the Bankruptcy Court in Maryland, Plaintiffs amended their Complaint.[4] The Amended Complaint alleges seven causes of action: (Count I) breach of an oral contract to protect Plaintiffs from liability as indemnitors of Liberty Mutual against Defendant Moore; (Count II) intentional interference with the contract between Plaintiffs and Liberty Mutual against all Defendants; (Count III) intentional misrepresentation or concealment regarding the financial strength of Railworks against Defendants Azarela and Larkin;[5] (Count IV) general negligence against all Defendants in failing to present Plaintiffs with notice of default of the PAAC contract; (Count V) intentional misrepresentation or concealment against all Defendants regarding Railworks' financial ability to guaranty HSQ's performance under the PAAC contract and its ability to protect Plaintiffs from liability to Liberty Mutual; (Count VI) breach of the Business

[4] Neither Fletcher nor Whiteford, Taylor & Preston are named as defendants in the Amended Complaint, however, Michael R. Azarela and John G. Larkin are named as defendants. Am. Compl. 1.

[5] Defendants Azarela and Larkin have not appealed the decision of the Bankruptcy Court.

and Professions Code of California and the California Civil Code against all Defendants; and (Count VII) indemnification from all Defendants for all expenses incurred in the lawsuit brought against Plaintiffs by Liberty Mutual and in pursuing claims in the Railworks and HSQ bankruptcies.[6]

On July 13, 2006, the Bankruptcy Court dismissed Counts I, IV and VII, finding that the third party injunction contained in the release provision of the Reorganization Plan prevented Plaintiffs from pursuing those counts. The Court held that Counts II, III, and V alleged reckless and willful misconduct, some of which occurred prior to the filing of the bankruptcy petition, which, if proven to be true, would be excepted from release provision.[7] After finding that Counts II, III, and V were not preempted by the Bankruptcy Code, the Court determined that the relevant factors supported remand of those counts to the Superior Court of California.

In the instant appeal, Defendants argue that the release provision of the Reorganization Plan enjoins all of Plaintiffs' claims and that the Bankruptcy Court erred in not fully

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[6] Plaintiffs also seek exemplary damages in connection with Counts III, V, and VI.

[7] The Court also upheld Count VI, noting that Plaintiffs predicated that claim on the conduct alleged in each of the preceding counts, including the actionable conduct alleged in Counts II, III, and V. Mem. & Order of the Bankr. Ct. dated July 13, 2006.

dismissing Plaintiffs' Amended Complaint. Further, Defendants contend that the remaining claims present state law causes of action which are preempted by the Bankruptcy Code. Finally, Defendants argue that the Bankruptcy Court erred in remanding the remaining claims to the Superior Court of California.

In their cross-appeal, Plaintiffs argue that the dismissed claims focus on pre-petition conduct and, as such, the Bankruptcy Court erred in finding that the release provision of the Reorganization Plan precluded litigation of the three dismissed Counts. Plaintiffs contend that the Amended Complaint should be reinstated in its entirety, removed from the bankruptcy proceeding, and remanded to the Superior Court of California.

II. STANDARD OF LAW

On appeal from the bankruptcy court, the district court acts as an appellate court and reviews the bankruptcy court's findings of fact for clear error and conclusions of law de novo. In re Johnson, 960 F.2d 396, 399 (4th Cir. 1992).

III. DISCUSSION

A. Claims Enjoined under the Plan of Reorganization

In exercising its equitable powers, a bankruptcy court may release the liabilities of non-debtors in certain circumstances. See In Re A.H. Robins Co., 880 F.2d 694, 702 (4th Cir. 1989) (finding that a bankruptcy court's power to release liability exists where the plan is overwhelmingly approved and the injunction is essential to a workable reorganization). Here,

neither party questions the validity of the injunction contained in the release provision of the Reorganization Plan. Rather, the parties dispute the scope of that provision, with Plaintiffs arguing that the claims of the Amended Complaint fit within the exceptions to the release provision, and Defendants arguing that the Bankruptcy Court should have construed the provision to preclude all of Plaintiffs' claims. As the Bankruptcy Court did, this Court will review the applicability of the release provision to each claim of the Amended Complaint separately.[8]

Count I of the Amended Complaint asserts a breach of an oral contract allegedly entered into between Hoge and Moore prior to the filing of the bankruptcy petition in which Moore agreed to protect Plaintiffs from liability as indemnitors of Liberty Mutual. Am. Compl. 3. The Bankruptcy Court held that the release provision of the Reorganization Plan barred Count I because the claim stated a general breach of contract and the alleged liability was asserted against Moore in his capacity as representative of Railworks. Mem. & Order of the Bankruptcy Court 8-9. Plaintiffs argue that the Bankruptcy Court misconstrued the allegations of the Amended Complaint which, properly read, assert a claim against Moore in his individual capacity, not in his capacity as a representative of Railworks. Specifically, Plaintiffs contend that their theory of liability assumes that, in forming the oral contract, Moore was operating

[8] The Bankruptcy Court's decision with respect to Count III, which has not been appealed, will be affirmed.

outside his representative capacity.

Count I relates to actions allegedly taken by Moore in his capacity as a representative of Railworks. Plaintiffs do not allege that Moore contracted to accept personal liability to Liberty Mutual for performance of the PAAC contract, but, rather, that Moore, in his capacity as a representative of Railworks, agreed that Railworks would indemnify Plaintiffs from their own personal liability. See, e.g., Am. Compl., Attach. A, ¶ 36 ("Hoge advised Moore that he . . . understood and believed that [Railworks] had assumed those liabilities in connection with [Railworks'] acquisition of HSQ"); Letter from Henry D. Hoge, President, HSQ Technology & C. William Moore, Vice President, Railworks Corporation, to Paul P. Skoutelas, CEO, Port Authority of Allegheny County (April 2, 2001) (Guaranty Letter) ("This letter is written on behalf of [Railworks] and its wholly owned, indirect subsidiary, HSQ[.] . . . If PAAC approves the foregoing . . . [Railworks] will guarantee and does hereby guarantee the performance of HSQ in accordance with the terms of the Contract."). Thus, this Court will uphold the finding of the Bankruptcy Court that Count I is asserted against a representative of the Debtor acting in his capacity as a representative, and, therefore, the release provision of the Reorganization Plan enjoins prosecution of the claim.

In Count II, Plaintiffs allege that Defendants willfully, recklessly, and intentionally interfered with the contract between Plaintiffs and Liberty Mutual by negotiating directly

with PAAC regarding the terms and conditions of the PAAC contract. Am. Compl. 4. Defendants argue that, while Count II nominally alleges willful and reckless conduct, Plaintiffs fail to allege facts to support the contention that Defendants interfered with the indemnification agreement between Plaintiffs and Liberty Mutual, or that Defendants owed Plaintiffs any duty of care. Defs. Br. 14-15. The Amended Complaint, however, alleges that, prior to the filing of the bankruptcy, Defendants negotiated a subcontract with a third party under the PAAC contract which incorporated the indemnification provisions of Plaintiffs' contract with Liberty Mutual. Am. Compl., Attach. A ¶¶ 43-55. Plaintiffs allege that Defendants did not have the authority to enter into such a subcontract and that Defendants' actions constituted willful and reckless misconduct. Id.; see also Am. Compl., Attach. A ¶¶ 64-68 (alleging further interference on the part of Defendants with the Liberty Mutual contract in the form of a letter written to Liberty Mutual threatening abandonment of the PAAC contract). The Court finds, as Bankruptcy Court did, that Count II alleges actions involving willful misconduct and recklessness, and, therefore, that Count II falls within a stated exception to the release provision. Second Am. Joint Plan of Reorganization § 11.6(b)(y) (Noting that the release provision will not operate to enjoin the prosecution of causes of action arising out of "acts or omissions to act involving willful misconduct, recklessness, or gross negligence").

In Count IV, Plaintiffs allege general negligence against all Defendants for failure to forward a letter of default sent by PAAC to HSQ's bankruptcy counsel, Martin Fletcher. Am. Compl. 7, Attach. A ¶ 69. Plaintiffs contend that their failure to receive the notice of default deprived them of a right to cure, which ultimately resulted in their liability to Liberty Mutual. Id. ¶ 70-75. Count IV asserts a general negligence claim based on post-petition actions taken by representatives of the Debtors acting in their capacity as representatives. The allegations of Count IV are covered by the release provision contained in the Reorganization Plan and, therefore, the Bankruptcy Court's decision to dismiss that count will be upheld.

In Count V, Plaintiffs allege fraud against all Defendants based on Moore's alleged pre-petition representation that Railworks would guaranty HSQ's performance under the PAAC contract and that Railworks would protect them from liability to Liberty Mutual. Plaintiffs allege that Railworks did not have the financial ability to guaranty HSQ's performance or to assume liability for the Liberty Mutual performance bonds. Further, Plaintiffs assert that Moore had no authority to make such representations, that he concealed or suppressed facts he was bound to disclose, and that he intended to defraud Plaintiffs and to induce them to act. Am. Compl. 8. Unlike Count I, which alleges a general breach of contract, the allegations of fraud contained in Count V, if proven to be true, constitute willful misconduct or recklessness on behalf of Defendants. Count V,

therefore, falls within the exception to the release provision of the Reorganization Plan. See Second Am. Joint Plan of Reorganization § 11.6(b)(y).

Count VI alleges that the actions underlying each preceding Count constitute a pattern or practice of activity which violates the California Business and Professions Code, Cal. Bus. & Prof. Code § 17200 et seq., and that Defendants' actions have deprived Plaintiffs of their retirement assets, in violation of the California Civil Code, Cal. Civ. Code § 3345. Am. Compl. 10. Count VI is predicated on the factual allegations underlying Counts I-V. Plaintiffs are enjoined from prosecuting Count VI only to the extent that they are enjoined from prosecuting the predicate claims. Thus, to the extent that Count VI is predicated upon the allegations of willful misconduct and recklessness, such as those found in Counts II, III, and V, it is not barred under the release provision of the Reorganization Plan.

In Count VII, Plaintiffs request indemnification from all Defendants for "all expenses incurred in connection with the lawsuits brought by Liberty Mutual . . . as well as for all attorneys fees expended . . . defending all collection actions brought by Liberty Mutual and in pursuing claims in the [Railworks] and HSQ Bankruptcies." Am. Compl. 11. Count VII seeks indemnification for costs incurred during the course of the bankruptcy case following the Bankruptcy Court's order of the rejection of the PAAC contract. The fees and expenses incurred

by Plaintiffs in "pursuing claims in the [Railworks] and HSQ Bankruptcies" result directly from the actions of the representatives of the Debtors, acting in their capacity as such, in the course of the bankruptcy adjudication. Thus, Count VII has been released and Plaintiffs are enjoined from prosecuting it against Defendants.

B. Preemption

The United States Congress has the constitutional power to preempt state law. U.S. Const. art. VI; Louisiana Pub. Serv. Comm'n v. FCC, 476 U.S. 355, 368 (1986). Among other scenarios, preemption may occur where Congress expresses a clear intent to preempt state law, or where Congress has legislated comprehensively, thus occupying an entire field of regulation and leaving no room for the States to supplement federal law. Louisiana Pub. Serv. Comm'n, 476 U.S. at 368-69. Because Congress has the constitutional power to enact laws governing bankruptcies, U.S. Const. art. I, § 8, cl. 4, a number of courts have held that, by enacting the Bankruptcy Code, Congress has preempted some state activity on matters affecting bankruptcy. Koffman v. Osteoimplant Techs., Inc., 182 B.R. 115, 123 (D. Md. 1995) (citing In re Demoff, 90 B.R. 391, 396 (Bankr. N.D. Ind. 1988)). Conversely, "because the common law of the various states provides much of the legal framework for the operation of the bankruptcy system, it cannot be said that Congress has completely preempted all state regulation which may affect the actions of parties in bankruptcy court." Id. (citing Paul v.

Monts, 906 F.2d 1468, 1475 (10th Cir. 1990) ("Where the Bankruptcy Code is silent, and no uniform bankruptcy rule is required, the rights of the parties are governed by the underlying non-bankruptcy law.")).

Here, Defendants argue that the Bankruptcy Court erred in concluding that the remaining claims were not preempted by the Bankruptcy Code. They allege that litigation of the remaining claims will interfere with the bankruptcy process by imposing state law standards on representatives of the Debtors for activities undertaken during the management of the Bankruptcy Cases. In forming their conclusion, Defendants rely primarily on the holdings in Koffman, 182 B.R. at 115, and MSR Exploration, Ltd. v. Meridian Oil, Inc., 74 F.3d 910 (9th Cir. 1996).

In Koffman, the Court relied on the extensive remedies provided by the Bankruptcy Code for willful violations of an automatic stay provision and for the filing of an involuntary bankruptcy petition in bad faith to find that causes of action predicated upon that conduct were preempted. 182 B.R. at 125-26. Similarly, in MSR, the Ninth Circuit held that a malicious prosecution action arising out of events taking place in the bankruptcy proceedings were completely preempted under federal law. 74 F.3d 910, 916.

Unlike the state law claims alleged in MSR and Koffman, which were predicated upon violations of the Bankruptcy Code, here, the underlying facts of Plaintiffs' claims do not presuppose such violations. Rather, the remaining claims are

based either on conduct specifically excepted from those proceedings or on conduct which occurred prior to the filing of the bankruptcy petition. In such a scenario, "no risk of conflict between enforcement of the state laws and enforcement of the federal bankruptcy laws [exists]." Dougherty v. Wells Fargo Home Loans, Inc., 425 F. Supp. 2d 599, 609 (E.D. Pa. 2006) (finding that "merely because a Plaintiff brings a state law claim in the context of a bankruptcy matter does not justify preemption of those claims, particularly where the underlying facts of the state law claim are not based on a violation of the Code"). Thus, the Bankruptcy Court's holding that Plaintiffs' claims are not preempted by federal law will be upheld.

C. Remand

Defendants argue that the Bankruptcy Court committed reversible error when it determined that the remaining claims should be remanded to the Superior Court of California pursuant to section 1452(b) of Title 28. That section provides district courts with discretion to remand a claim or cause of action removed to federal court pursuant to section 1452(a) of Title 28 "on any equitable ground." 28 U.S.C. § 1452(b). The Bankruptcy Court's decision to remand, like other discretionary decisions, is reviewed only for abuse of discretion. In re Merry-Go-Round Enterprises, Inc., 222 B.R. 254, 256 (D. Md. 1998).[9]

[9] In addition to supporting the Bankruptcy Court's decision to remand the remaining claims, Plaintiffs argue that the Court should have abstained from hearing those claims under both the mandatory and permissive abstention provisions found in 28 U.S.C.

In making its remand determination, the Bankruptcy Court considered several factors, including: "(1) the effect on the efficient administration of the bankruptcy estate; (2) the extent to which issues of state law predominate; (3) the difficulty or unsettled nature of applicable state law; (4) comity; (5) the degree of relatedness or remoteness to the proceeding in the main bankruptcy case; (6) the existence of the right to a jury trial; and (7) prejudice to the involuntarily removed defendants." Mem. & Order of the Bankr. Ct. dated July 13, 2006 (citing In re Merry-Go-Round Enterprises, Inc., 222 B.R. at 257). The Bankruptcy Court properly found that several of these factors supported remand, noting that the "remaining claims are all based on State law" and that "the California Superior Court is in a better position to adjudicate these state law claims." Id.

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§ 1334(c). Conversely, Defendants argue that abstention would have been inappropriate here, arguing primarily that abstention cannot apply where no pendent state action currently exists. While the Fourth Circuit has not addressed the issue, Courts which have are divided in their interpretations of the relationship between § 1334 and § 1452. Compare Sec. Farms v. Int'l Bhd. of Teamsters, 124 F.3d 999, 1009 (9th Cir. 1997) (finding that abstention does not apply to state court actions removed to federal court under 28 U.S.C. § 1452(a) because "[a]bstention can exist only where there is a parallel proceeding in state court") with Massey Energy Co. v. West Virginia Consumers for Justice, 351 B.R. 348, 352-53 (E.D. Va. 2006) (noting that the majority of courts have concluded that "§ 1334(c)(2) [applies] to cases that have been removed under § 1452" and adopting "the majority view that a state law claim originally brought in state court, then removed, still is considered 'commenced' within the meaning of the statute"). Here, the Court need not resolve this legal issue because the Court has found that, in any event, the Bankruptcy Court's decision to remand the remaining claims to the state court did not constitute an abuse of discretion.

Specifically, the Bankruptcy Court noted that Claim VI was "based on two California statutes that can best be interpreted by the California Superior Court." Id. Finally, the Bankruptcy Court considered that Plaintiffs have demanded and may be entitled to a jury trial and that the remaining claims are not alleged against the Debtor, but non-Debtor individuals, making the claims at issue sufficiently remote from the Railworks bankruptcy. Id.; In re Merry-Go-Round Enterprises, Inc., 222 B.R. at 257 (noting that additional factors courts have considered include the efficient use of judicial resources and the possibility of inconsistent results). While Defendants argue that each of the factors listed favors denial of remand, the Court finds no evidence that the Bankruptcy Court abused its discretion in deciding that remand was appropriate under the circumstances.

IV. CONCLUSION

For these reasons, the decision of the Bankruptcy Court will be affirmed. A separate order consistent with the reasoning of this Memorandum will follow.

/s/

William M. Nickerson
Senior United States District Judge

Dated: April 26, 2007